No. 22-800

IN THE

Supreme Court of the United States

CHARLES G. MOORE AND KATHLEEN F. MOORE,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Writ of Certiorari to the United States
Court of Appeals for the Ninth Circuit

BRIEF OF ALEX ZHANG AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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INTEREST OF AMICUS CURIAE[1]

Alex Zhang is an assistant professor of law at Emory University. The question presented is whether the Sixteenth Amendment authorizes Congress to tax unrealized sums without apportionment among the states. Professor Zhang is interested in and has conducted research on this question, in particular on *Eisner v. Macomber*, 252 U.S. 189 (1920).

This brief draws from the more extensive treatment presented in the article Alex Zhang, *Rethinking* Eisner v. Macomber*, and the Future of Structural Tax Reform,* 92 Geo. Wash. L. Rev. (forthcoming Feb. 2024).[2]

[1] Pursuant to Sup. Ct. R. 37.6, *amicus curiae* affirms that no counsel for a party has written this brief in whole or in part, and that no person or entity, other than amicus curiae, its members, or its counsel, has made a monetary contribution to the preparation or submission of this brief.
[2] Available at https://papers.ssrn.com/abstract_id=4551857.

INTRODUCTION AND SUMMARY OF THE ARGUMENT

The Constitution authorizes Congress to "lay and collect Taxes" and provides that "direct Taxes shall be apportioned among the several States" in accordance with states' populations. U.S. Const. art. I, § 8, cl. 1; *id.*, § 2, cl. 3. The Sixteenth Amendment authorizes Congress "to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const. amend. XVI. *Eisner v. Macomber*, 252 U.S. 189 (1920), and its doctrinal progeny are central to Congress's power to tax unrealized gains under the Sixteenth Amendment. In particular, Petitioners rely on *Macomber* to argue Congress can only tax realized gains under the Sixteenth Amendment. Pet. Br. 1–2, 14–15, 17–22.

Macomber held that *pro rata* stock dividends are not constitutionally taxable. 252 U.S. at 219. The ruling articulated five distinct models of Congress's power under the Sixteenth Amendment: Congress could tax an object or transaction where (1) the taxpayer receives economic income; (2) the taxpayer receives an asset separate from the initial capital investment; (3) the taxpayer receives liquid gains; (4) the taxpayer disposes of the initial capital investment; or (5) the taxpayer gains full control of a new asset. The absence of income was most important to this Court's decision in *Macomber*, but each model is independently sufficient to support its holding.

In subsequent cases on lease improvements and corporate reorganization, this Court refined *Macomber*'s doctrinal framework. It eliminated, *inter*

alia, the receipt of separate assets as a constitutional requirement of income. Today, only the income model of *Macomber* remains. That is, *Macomber* stands for the proposition that Congress may tax as income an object or transaction generative of economic income or accretion to wealth, without regard to realization.

ARGUMENT

I. UNDER *EISNER v. MACOMBER*, CONGRESS CAN TAX AS INCOME AN OBJECT OR TRANSACTION THAT GENERATES ECONOMIC INCOME

Article I of the Constitution grants Congress the "Power To lay and collect Taxes, Duties, Imposts and Excises," but provides that "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census." U.S. Const. art. I., § 8, cl. 1; *id*., § 9, cl. 4. Ratified in 1913, the Sixteenth Amendment authorizes Congress "to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const. amend. XVI. Thus, Congress can impose income and indirect taxes at uniform rates, without regard to apportionment.

In *Eisner v. Macomber*, this Court construed the constitutional meaning of income under the Sixteenth Amendment. 252 U.S. 189 (1920). *Macomber* was decided against a doctrinal background that had upheld unapportioned federal taxation of income during the Civil War. *See Springer v. United States,* 102 U.S. 586 (1880). Further, in *Towne v. Eisner*, this Court held under the Revenue Act of 1913 that

pro rata stock dividends were not taxable income, on the ground they generated no economic income. 245 U.S. 418, 426 (1918); *see* Revenue Act of 1913, Pub. L. No. 63-16, § 2(b), 38 Stat. 114, 167. This Court concluded: "[T]he stockholder is no richer than they were before [the receipt of stock dividends.]" 245 U.S. at 426. Importantly, the *Macomber* Court explicitly constitutionalized the income-based, statutory holding of *Towne*.

Macomber itself held that *pro rata* stock dividends were not taxable under the Sixteenth Amendment. 252 U.S. at 219. This holding can be read to turn on (1) the absence of income (*pro rata* stock dividends generated no income to the taxpayer because their proportionate ownership interest in the company remained unchanged); (2) the receipt of separate assets (the taxpayer received no asset from the company separate from the initial capital investment); (3) the receipt of liquid assets (dividend stocks were not liquid due to the absence of mature stock markets in the 1910s); (4) the disposition of the initial capital investment (the taxpayer continued to hold their investment in the dividend-declaring company); or (5) the gain of control over a new asset (the taxpayer had no right to withdraw profits from the company). Each model independently supports *Macomber*'s holding.

This Court refined *Macomber*'s framework in subsequent caselaw. In the lease-improvement cases, this Court found Congress could tax accrued gains in the underlying property held by the lessor-taxpayer, where the lessee constructed new buildings which enhanced the value of the property. This Court

concluded that neither the receipt of separate assets nor disposition was required for constitutional taxability. *See, e.g.*, *Helvering v. Bruun*, 309 U.S. 461, 469 (1940) ("It is not necessary to recognition of taxable gain that [the taxpayer] should be able to sever the improvement begetting the gain from his original capital."); *infra* Section I.C.2. "[E]nhancement in value," that is, any economic income or accretion to wealth, was enough. *Bruun*, 309 U.S. at 469.

In the corporate-reorganization cases, this Court upheld federal taxation of stock dividends that changed the shareholders' proportionate ownership interests in the company. *See Helvering v. Sprouse*, 318 U.S. 604, 607–08 (1943). Because changes in ownership interests could result in economic income (or loss), this Court affirmed the income model of *Macomber*. *See infra* Section I.C.1. The taxpayer's lack of control over the corporate assets posed no constitutional obstacle to uniform taxation.

Following Stanley Surrey, commentators have adopted the view that *Macomber* imposes a realization requirement on Congress's power to tax income. *See* Stanley S. Surrey, *Supreme Court and the Federal Income Tax: Some Implications of the Recent Decisions*, 35 Ill. L. Rev. 779 (1941). But today's doctrinal landscape is clear: *Eisner v. Macomber* is a case about income, not realization. Congress can tax an object or a transaction constitutive of an accretion to the taxpayer's wealth.

A. Pre-*Macomber* caselaw held stock dividends statutorily non-taxable on the ground they did not generate economic income

Macomber was decided in the context of four key precedents. In the first pair of cases—*Collector v. Hubbard* and *Springer v. United States*—this Court upheld federal taxation of income during the Civil War. *See Collector v. Hubbard*, 79 U.S. (12 Wall.) 1 (1870); *Springer v. United States*, 102 U.S. 586 (1880). Thereafter, in *Pollock v. Farmers' Loan & Trust Co.*, this Court held that a tax on the income from real or personal property must be apportioned under the Constitution.[3] Most importantly, in *Towne v. Eisner*, this Court construed the Revenue Act of 1913, which provided that dividends were taxable income, and held that *pro rata* stock dividends were not statutorily taxable because they generated no economic income. 245 U.S. at 418; Revenue Act of 1913, § 2(b), 38 Stat. at 167.

In *Hubbard*, this Court affirmed Congress's power to tax stockholders for their shares of undistributed corporate profits. Under the Revenue Act of 1864, Congress taxed as income an individual owner's share of a company's profits, "whether divided or otherwise." Revenue Act of 1864, ch. 173, § 117, 13 Stat. 223, 281. The taxpayer in *Hubbard* owned shares in two manufacturing companies that had used accumulated profits to invest in business properties (rather than distributing them to the shareholders).

[3] *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895) *(Pollock I); Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895) *(Pollock II)* [hereinafter collectively referred to as *Pollock*].

79 U.S. (12 Wall.) at 2. The question presented in *Hubbard* was about statutory construction: "[W]ere the undivided profits [of the manufacturing companies in which the taxpayer held ownership interests] 'income' within the meaning of the [Revenue] Act of 1864?" *Id.* at 4. This Court first held that Congress intended to tax all undistributed corporate profits, and "properly included" manufacturing companies in its taxation of unrealized gains. *Id.* at 17. This Court then concluded Congress both had the constitutional authority to tax undistributed corporate profits to the shareholder and intended to tax them. This Court held: "[T]he decisive answer . . . is that Congress possesses the power to lay and collect taxes, duties, imposts, and excises, and it is as competent for Congress to tax annual gains and profits before they are divided among the holders of the stock as afterwards." *Id.* at 18.

In 1880, *Springer* sustained the unapportioned Civil War income tax against a broad constitutional attack. Relying on longstanding legislative practice and judicial constraint, this Court held "direct" taxes included only real-estate and capitation taxes. *Springer*, 102 U.S. at 602; *see Hylton v. United States*, 3 U.S. (3 Dall.) 171 (1796) (upholding an unapportioned tax on carriages); *Pac. Ins. Co. v. Soule*, 74 U.S. (7 Wall.) 433 (1869) (upholding an unapportioned tax on insurance premiums); *Veazie Bank v. Fenno*, 75 U.S. (8 Wall.) 533 (1869) (upholding an unapportioned tax on state-bank notes paid out by other banks); *Scholey v. Rew*, 90 U.S. (23 Wall.) 331 (1874) (upholding an unapportioned succession tax). This Court stated: "Our conclusions are, that direct taxes, within the meaning of the Constitution, are only

capitation taxes, as expressed in that instrument, and taxes on real estate; and that the tax of which [Springer] complains is within the category of an [indirect] excise or duty." *Springer*, 102 U.S. at 602.

In *Pollock*, this Court struck down the income tax of 1894 as an unapportioned direct tax, on the ground that a tax on income from real or personal property was a tax on the property itself and therefore subject to the Constitution's apportionment clause. *Pollock II*, 158 U.S. at 637. This Court distinguished *Pollock* from *Springer* based on two facts: (1) The taxpayer in *Springer* had income from professional services and interest on government bonds, not from real estate; and (2) *Springer* did not specifically say that a tax on income from real or personal property was not equivalent to a tax on real or personal property itself. *Pollock I*, 157 U.S. at 578–79.

The Sixteenth Amendment abrogated the outcome of *Pollock I* and authorized Congress to tax income without regard to apportionment. U.S. Const. amend. XVI. Pursuant to the Sixteenth Amendment, Congress soon enacted the Revenue Act of 1913 and proceeded to tax "the entire net income arising or accruing from all sources." Revenue Act of 1913, § 2(a), 38 Stat. at 166. In particular, the Act defined "net income" to include all "gains, profits, and income derived from . . . interest, rent, *dividends*, securities, or the transaction of any lawful business carried on for gain or profit . . . ." *Id.* § 2(b), 38 Stat. at 167 (emphasis added). The Treasury Department interpreted the statutory definition of "net income" to include stock dividends. T.D. 2274, 17 Treas. Dec. Int. Rev. 279, 279 (1915).

In *Towne v. Eisner*, this Court addressed Congress's taxation of stock dividends for the first time. 245 U.S. 418 (1918). In *Towne*, a manufacturing company issued stock dividends to its shareholders in 1914. 242 F. 702, 704 (S.D.N.Y. 1917). The stock dividends were *pro rata*: that is, they were proportional to the number of existing stocks held by the shareholders, and their issuance did not change the shareholders' proportional ownership interests in the company. *Id.* This Court held the *pro rata* stock dividends not taxable under the Revenue Act of 1913, on the ground that they resulted in no accretion to the taxpayer's wealth. 245 U.S. at 426. Justice Holmes wrote:

> "A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished, and their interests are not increased. . . . The proportional interests of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of new ones." In short, the corporation is no poorer and *the stockholder is no richer* than they were before.

Id. (quoting *Gibbons v. Mahon*, 136 U.S. 549, 559–560 (1890)) (citing *Logan County v. United States*, 169 U.S. 255, 261 (1890)). That is, the taxpayer received no economic income because (1) the company was worth exactly the same before and after the declaration of the stock dividend; and (2) *pro rata* stock dividends

did not change the taxpayer's proportional ownership interest in the company. Thus, as a statutory matter, the controlling law before *Macomber* was that stock dividends were not taxable *because they did not constitute economic income to the shareholder*.

B. *Eisner v. Macomber* held Congress could not tax stock dividends under the Sixteenth Amendment, with five distinct models of constitutional income

Towne was a statutory decision. Congress was free to modify the decision by amendment, and it did precisely that. Under the Revenue Act of 1916, "stock dividend shall be considered income, to the amount of its cash value." Revenue Act of 1916, ch. 463, 39 Stat. 756, 757. This congressional override of *Towne*'s statutory ruling paved the path for *Eisner v. Macomber*. In 1916, the Standard Oil Company of California declared a half stock dividend for each existing stock. *Macomber*, 252 U.S. at 200. As relevant here, the *Macomber* taxpayer owned 2,000 shares of the existing Standard Oil stock, received certificates for 1,100 additional stocks as dividends, and paid income taxes under protest on those 1,100 dividend stocks. *Id.* at 200–01. The stock dividends were, as in *Towne*, *pro rata* and did not change any shareholder's proportional ownership of the company. *Id.*

In *Macomber*, this Court held that Congress had no power to tax *pro rata* stock dividends under the Sixteenth Amendment. 252 U.S. at 219. The *Macomber* Court rested its holding on five different rationales: (1) income; (2) receipt of separate assets; (3) liquidity; (4) disposition; and (5) control.

The first and most prominent interpretive model adopted by *Macomber* asks whether the taxpayer has received economic *income* through the object or transaction taxed by Congress. After a recitation of facts, this Court in *Macomber* bifurcated its doctrinal analysis, and asserted that (1) *Towne v. Eisner* controlled as precedent; and (2) a re-examination of the question confirmed that *Towne*'s decision and reasoning were sound. *Id.* at 201. *Towne* was a statutory case, while *Macomber* presented a constitutional question. This Court in *Macomber* therefore stated that *Towne* "treated the construction of the [Revenue Act of 1913] as inseparable from the interpretation of the Sixteenth Amendment." *Id.* at 202–03. That is, the constitutional and the statutory meanings of "income" were co-extensive. *Macomber* then relied on *Towne*'s reasoning that the "proportional interest of each shareholder remains the same" and that "the stockholder is no richer than they were before" to hold stock dividends *constitutionally* non-taxable. *Id.* at 203. *Macomber* thus constitutionalized the statutory holding of *Towne*: Congress's inability to tax stock dividends rested on the absence of economic income generated by those dividends. As in *Towne*, *pro rata* stock dividends "[did] not alter the preëxisting proportionate interest of any stockholder *or increase the intrinsic value of his holding* . . . ." *Id.* at 211 (emphasis added). Because the taxpayer received no economic income from the stock dividends, Congress could not tax them.

The parties' briefs in *Macomber* confirm the income model. In the brief for the taxpayer, Charles E. Hughes (who had served as Associate Justice on the

Supreme Court until 1916 and would later become Chief Justice in 1930) wrote:

> The *fundamental* fact is that there was *no gain or income* to the defendant-in-error [(i.e., the taxpayer)] by virtue of the receipt of the additional shares constituting the 'stock dividend.' The value of the shares held by the defendant-in-error was not increased by the increase in the number of shares. The shareholder was *no richer than before*.

Br. and Argument for Defendant-in-Error at 11, *Macomber*, 252 U.S. at 189 (emphasis added); *see also id.* at 40 ("[I]f [stock dividends] are not income in the sense that they make the shareholder richer than he was before, it can hardly be contended that they should be regarded as income within the meaning of the constitutional provision."). The government countered: "The fundamental and *controlling* fact is that defendant in error *is richer than she was* on March 1, 1913, to the extent of 198 shares of Standard Oil stock . . . ."[4] Supp. Br. for the United States at 10, *Macomber*, 252 U.S. at 189.

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[4] That is, in *Macomber*, the government and the taxpayer agreed the fundamental and dispositive question is whether the shareholder received any economic income—the thrust of the income model. What they disagreed on is the timing and the actual object of taxation. The taxpayer argued that Congress intended to tax stock dividends, which did not make the taxpayer any richer than before. *See* Br. and Argument for Defendant-in-Error at 13, 17, *Macomber*, 252 U.S. at 189. The government argued Congress intended to tax the stockholder's share of the company's profits, and the company's accumulated profits since 1913 did make the taxpayer richer than before. *See* Br. for the United States at 14–28, *Macomber*, 252 U.S. at 189.

The second model in *Macomber* asks whether the taxpayer has received a separate asset from the taxed transaction. This Court noted that *income* was:

> *not* a gain *accruing to* capital; not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value, *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in*, being '*derived*'—that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal—*that* is income derived from property.

Macomber, 252 U.S. at 207. Stock dividends were "in essence not a dividend [as] no part of the assets of the company [was] separated from the common fund, [and] nothing [was] distributed." *Id.* at 210. And "[t]he stockholder has received nothing out of the company's assets for his separate use and benefit." *Id.* at 211. In short, "segregation of profits" was required before Congress could tax something as income under the Sixteenth Amendment. *Id.* at 213. Following Stanley Surrey, *supra*, commentators today have often adopted this model and read *Macomber* to require realization in the form of receipt of separate assets.

The remaining three models of income are less prominent, but *Macomber* still relied on them to hold stock dividends non-taxable. Centering on liquidity, the third model asks whether the taxpayer has received a liquid or marketable good whose sale could fund the payment of the assessed tax. The *Macomber* Court recognized this concern: "[W]ithout selling [the stock dividends], the shareholder, unless possessed of

other resources, has not the wherewithal to pay an income tax upon the dividend stock."[5] *Id.*

Under the fourth model, Congress could tax something as income only if the taxpayer disposes of their initial capital investment. This would be a conditional requirement: That is, where the taxpayer has not received property (e.g., cash dividend or some other asset) *separate* from the underlying property holding (e.g., her ownership interest in a publicly traded company), Congress may tax the growth in value of the *underlying* property holding *only if* the taxpayer disposes of it. *Id.* at 204.

Finally, the fifth model articulated by *Macomber* centers on the problem of control—whether the taxpayer has gained full control of a new asset. As this Court noted, absent liquidation or declaration of a cash dividend, stockholders "ha[d] no right to withdraw any part of either capital or profits from the common enterprise." *Id.* at 208. Stock dividends gave the taxpayer in *Macomber* no more control of the corporation's assets than before.

Thus, *Macomber* articulated five distinct rationales for its holding that Congress could not tax stock dividends. The income model was the most important for this Court's decision: *Macomber* expressly constitutionalized the income-based statutory ruling of *Towne*, which this Court said

[5] The *Macomber* Court's concern regarding liquidity may strike a modern reader as odd. But many stocks were illiquid and only thinly traded during the 1910s due to the absence of mature, broad-based stock markets in the United States. *See* Mary O'Sullivan, *The Expansion of the U.S. Stock Market, 1885–1930*, 8 Ent. & Soc'y 489 (2007).

"controlled." *Id.* at 201. The parties also understood the presence (or absence) of economic income as the "fundamental" and "controlling" question of their dispute.

C. Post-*Macomber* doctrinal development affirms Congress's power to tax economic income, without requiring disposition or receipt of separate assets

Macomber held that *pro rata* stock dividends were not taxable under the Sixteenth Amendment, based on five models of income: (1) economic income; (2) receipt of separate asset; (3) receipt of liquid asset; (4) disposition of initial capital investment; and (5) control over a new asset.

In two lines of subsequent caselaw, this Court refined *Macomber*'s framework. First, in the lease-improvement cases, this Court concluded that neither the receipt of separate assets nor disposition was required for constitutional taxability, overruling models (2) and (4), respectively. These cases affirmed the income model (1), under which the presence of economic income is enough for taxation under the Sixteenth Amendment. *See infra* Section I.C.1.

Second, in the corporate-reorganization cases, this Court upheld the constitutionality of federal taxation of stock dividends that changed the shareholders' proportionate ownership interests in the company. *See, e.g.*, *Helvering v. Sprouse*, 318 U.S. 604, 607–08 (1943). In these cases, changes in ownership interests could result in economic income (or loss), and this Court again affirmed the income model (1). The taxpayer's lack of control over the corporate assets

posed no constitutional obstacle to uniform taxation under the Sixteenth Amendment. *See infra* Section I.C.2.

Macomber and subsequent case law show that Congress can tax any accretion to the taxpayer's wealth as income under the Sixteenth Amendment, *without* regard to realization.

1. In the lease-improvement cases, this Court has affirmed Congress's power to tax accrued gains in real property where the taxpayer has received no separate asset and has not disposed of their initial capital investment

From the 1920s to the 1940s, a series of cases regarding lease improvements provided crucial doctrinal gloss on the meaning of *Macomber*. These disputes generally arose from (1) a lessee's demolition of an old building and erection of a new one on leased land, with title vesting in the lessor, and (2) the lessee's subsequent default on the lease, with the lessor regaining control over the leased premises. As a result of the improvement, the lessor experienced an accretion to wealth in the form of the value differential between the erected new building and the demolished old building. In these cases, this Court affirmed Congress's power to tax accrued gains in real property where the taxpayer has received no separate asset and has not disposed of their initial capital investment.

The lease-improvement cases arose from a circuit split. The Ninth Circuit held in 1919 that where a lessee erected a new building on leased land, the lessor-taxpayer received economic income only in the

year of the new building's construction. *Miller v. Gearin*, 258 F. 225, 226 (9th Cir. 1919) (concluding that any income was " 'derived' . . . when the completed building was added to the real estate and enhanced its value"). By contrast, in 1935, the Second Circuit held Congress had no power to tax the lessor for the enhancement of value resulting from new buildings constructed by the lessee on the lessor's property. *Hewitt Realty Co. v. Comm'r*, 76 F.2d 884 (2d Cir. 1935). Following a realization reading of *Macomber*, Judge Learned Hand asked: "The question . . . is whether the value received is embodied in something *separately disposable*, or whether it is so merged in the land as to become financially a part of it, something which, though it increases its value, has no value of its own when torn away." *Id.* Because the new building obviously could not be taken off the land and sold "as separate chattels," the lessor realized no income taxable under the Sixteenth Amendment. *Id.*

With the circuit split, this Court spoke, first in *M.E. Blatt Co.*, 305 U.S. 267 (1938), then decisively in *Helvering v. Bruun*, 309 U.S. 461 (1940). In *M.E. Blatt*, the Court held for the taxpayer but equivocated as to the grounds of its decision. *See M.E. Blatt Co.*, 305 U.S. at 276. That case involved the lease of a movie theater where the lessee was required to install theater seats and film apparatus that became property of the lessor at termination of the lease. *Id.* at 274–275. This Court rejected the view that improvements made by the lessee, at least in the context of the movie theater, were imputed rent. *Id.* at 277–278. Instead, the costs of installing furniture and film apparatus were like operating costs. *Id.*

But *M.E. Blatt* did not hold realization (in the form of receipt of separate assets) as the *exclusive* test of what Congress could tax as income. To be sure, *M.E. Blatt* asserted that receipt of separate assets with exchangeable value was a component of constitutional income. *Id.* at 279 ("Granting that the improvements increased the value of the building, that enhancement is not realized income of lessor." (citing *inter alia Hewitt Realty Co.*, 76 F.2d at 884; *Macomber*, 252 U.S. at 207)). At the same time, this Court also endorsed the income model of *Macomber*, and thought it "conjectural" the "assumption that the [costs of installation] represent enhancement of value of the leased premises by reason of the improvements." *Id.* at 278. That is, Congress's income-tax power extended only to instances of *real* accretion to wealth resulting from the object taxed.

Justice Harlan Fiske Stone concurred in the majority opinion in *M.E. Blatt*: He saw the majority's commentary on realization as an unnecessary advisory opinion. *Id.* at 280 (Stone, J., concurring). The crux of *M.E. Blatt*, Justice Stone noted, was not whether the taxpayer *realized* any income, but whether the taxpayer received *any income at all*. *Id.* Because the facts failed to show the lessee-made improvements generated economic income to the lessor, realization, even if it were a requirement to taxability, had no place in the disposition of the dispute. *Id.* ("I acquiesce in that part of the Court's opinion which construes the findings below as failing to establish that the lessees' improvements resulted in an increase in market value of the lessor's land in the taxable year."). Justice Stone's concurrence in *M.E. Blatt* reflected the income model of *Macomber*,

and anticipated this Court's decision in *Helvering v. Bruun*.

In *Bruun*, this Court spoke decisively, and held without dissent that the federal government's power to tax income did not depend on the receipt of a separate asset or the taxpayer's disposition of their initial capital investment. 309 U.S. at 468–69. The taxpayer leased real property for 99 years to the lessee, who demolished the old building and erected a new one before defaulting on rent payments in 1933. *Id.* at 464–65. The taxpayer argued that "the economic gain consequent upon the enhanced value of the [leased real estate] is not gain derived from capital or realized within the meaning of the Sixteenth Amendment and may not, therefore, be taxed without apportionment." *Id.* at 467. This Court squarely rejected this contention: As long as the lessee's improvement increased the value of the lessor's real estate, the lessor received income to the amount of that added value in the year of repossession due to default. *Id.* at 468.

Importantly, this Court dismissed *Macomber*'s language about the need to receive separate assets from the corporation. That comment, *Bruun* explained, was "meant to show that in the case of a stock dividend, the stockholder's interest in the corporate assets after receipt of the dividend was the same as and inseverable from that which he owned before the dividend was declared." *Id.* at 469. In other words, *Bruun* characterized realization and the receipt of separate assets as a *proxy* for the absence of economic income: it only indicated stockholders had the same proportionate ownership interests in the

company before and after the declaration of a stock dividend. The same proportionate ownership, in turn, meant the taxpayer owned the same percentage of a company with the same valuation—that is, the taxpayer experienced no accretion to their wealth. In this way, *Bruun* concluded "recognition of taxable gain" does not require that the taxpayer "be able to sever the improvement begetting the gain from his original capital." *Id.*

Thus, the lease-improvement cases affirmed Congress's power to tax accrued gains in real property even if the taxpayer received no separate assets and did not dispose of their initial capital investment.

2. In the corporate-reorganization and subsequent stock-dividend cases, this Court has affirmed the income model of *Macomber* without requiring control or disposition

This Court also refined *Macomber*'s doctrinal framework in a series of cases regarding corporate reorganizations and stock dividends from 1921 to 1942. This Court eventually concluded that Congress's power to tax stock dividends rested on a change in the stockholders' proportionate ownership interest in the company—that is, when the stock dividends resulted in economic income to the taxpayer. *Helvering v. Sprouse*, 318 U.S. 604, 607–08 (1943).

The reorganization cases generally arose when a corporation either re-incorporated or split its operations into two companies—the existing company and a new corporation. The corporation's business

model (and often its name) did not change, and the intrinsic value of the entire business remained the same before and after the reorganization. In this process, the stockholders of the existing company would receive stock dividends and ownership interests in the new company. Often, but not always, the stockholders' proportionate interests in the existing and new corporations combined would remain the same. The question presented in the reorganization cases was whether the federal government could constitutionally tax the stockholders' receipt of stock dividends under the Sixteenth Amendment.

At first, this Court held Congress could tax such stock dividends where the taxpayer received materially different ownership interests in the transaction. In *United States v. Phellis*, the E.I. DuPont Company, a New Jersey chemical manufacturer, formed a new corporation under the laws of Delaware and transferred all its assets to the Delaware company. 257 U.S. 156, 166–67 (1921); *see also Rockefeller v. United States*, 257 U.S. 176 (1921) (companion case). In turn, each common stockholder of the New Jersey company received two dividend common stocks in the Delaware company. *Phellis*, 257 U.S. at 166–67.

This Court held those stock dividends were constitutionally taxable as income to the stockholders. *Id.* at 170. The dispositive question was whether the "stockholders [had] property rights and interests materially different from those incident to ownership of stock in the old company." *Id.* at 173. In *Phellis*, this Court concluded the taxpayer did receive materially different property interests after the

reorganization: The New Jersey company formed a *new* corporation, organized "under the law of a *different State*" and subject to "presumably different rights between stockholders and the company and between stockholders *inter sese*." *Id.* The "materially-different-interest" test is more consistent with the disposition and realization models of *Macomber*. As this Court explained, if the shareholders have received materially different property interests in the form of the stock dividends, they have received "separate property" and "actual exchangeable assets" that satisfied the constitutional requirement of *Macomber*. *Id.* at 175; *Rockefeller*, 257 U.S. at 183.

However, this Court gradually moved away from the "materially-different-interest" test and its associated requirement of realization. In *Weiss v. Stearn*, this Court returned to an income model of *Macomber*. 265 U.S. 242 (1924). The *Stearn* stockholders had full ownership of the old company before the reorganization and received half of the stocks in the new company (incorporated in the same state), as well as cash for the other half of their share in the business. *Id.* at 251–52. The government argued the stockholders should be taxed on their receipt of (half of) the stocks in the new company in addition to the cash. *Id.* at 252. This Court disagreed. Writing for the majority, Justice McReynolds stated the reorganization was "a transfer of the old assets and business, *without increase or diminution* or material change of general purpose, to the new corporation," and "an exchange of the remain[ing half of the stocks] for new stock representing the *same proportionate interest* in the enterprise." *Id.* As the "value of [the taxpayer's] holdings" remained the

same, the taxpayer did not receive any taxable, separate income under *Macomber*. *Id.* at 253 (citing *Macomber*, 252 U.S. at 189 (1920)).

Then in *Marr v. United States*, 268 U.S. 536 (1925), this Court appeared to endorse a standard that incorporated both the materially-different-interest test and the proportionate-ownership test. Congress could tax a stockholder's receipt of corporate shares as long as the stockholders did not "have the same proportional interest of the same kind in essentially the same corporation" after the reorganization. *Marr*, 268 U.S. at 542. By this point in 1925, it was unclear precisely how the corporate-reorganization cases affected *Macomber* as a constitutional precedent. This Court at first rejected the income model and hewed to the disposition and realization models in *Phellis*. But this Court returned to the income model in *Stearn*, and *Marr* gave credence to all three models without guidance on which controlled.

The next phase of doctrinal evolution reached a more decisive conclusion. In 1936, *Koshland v. Helvering* came before this Court. 298 U.S. 441 (1936). *Koshland* was not a corporate-reorganization case, but presented the question whether Congress could tax a stockholder for the receipt of *common voting* stock dividends on the basis of their existing *preferred nonvoting* stocks.[6] *Id.* at 442. *Macomber*

[6] The precise dispute in *Koshland* involved basis allocation. In 1924 and 1926, the taxpayer bought *preferred* stocks of Columbia Steel Corporation. Between 1925 and 1928, Columbia Steel chose to pay dividends on existing preferred stocks *in common stock*. The taxpayer therefore received common stocks as

held, at a minimum, that the receipt of *common* stock dividends on the basis of existing *common* stocks, without changing the shareholders' proportionate ownership interests, was beyond Congress's powers under the Sixteenth Amendment. 252 U.S. at 219. *Koshland* was therefore a more direct challenge to *Macomber*'s doctrinal reach.

Relying on the logic of the corporate-reorganization cases, this Court held the receipt of common voting stocks on the basis of nonvoting preferred stocks was *income*, and was *not* accrual to capital under *Macomber*. *See Koshland*, 298 U.S. at 443–45 (analyzing *Towne*, *Macomber*, and the corporate-reorganization cases). The precise ground of *Koshland*'s decision, however, is hard to decipher. The *Koshland* majority characterized the corporate-reorganization cases as making a "distinction" between (1) "a stock dividend which worked no change

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dividends. In 1930, Columbia Steel redeemed the preferred stocks from the taxpayer. Gain from sale of stocks is in general calculated by subtracting the cost basis (what the taxpayer paid for the asset) from the amount realized (what the taxpayer received in consideration upon disposition of the asset). *See* 26 U.S.C. § 1001; Revenue Act of 1928, Pub. L. No. 70-562, §§ 111(a), 113, 45 Stat. 791, 815, 818. Instead of subtracting from the amount realized what the *Koshland* taxpayer paid to buy the preferred stocks, the Commissioner allocated part of that cost basis to the taxpayer's common stock dividends. This allocation resulted in an increase in the taxpayer's liability. Herein arose the question in *Koshland*: If the common stock dividends were *returns to capital* (and *not* income), the Commissioner was right to decrease the taxpayer's cost basis. But if the common stock dividends were *income* (and *not* returns to capital), the Commissioner had no power to reduce the taxpayer's cost basis. *See Koshland*, 298 U.S. at 443–47.

in the corporate entity, *the same interest in the same corporation* being represented after the distribution by more shares of precisely the same character," and (2) "such a dividend where there had either been changes of corporate identity or a change in the nature of the shares issued as dividends whereby the *proportional interest of the stockholder* after the distribution was *essentially different* from his former interest." *Id.* at 445 (citing *Phellis*, 257 U.S. at 156; *Rockefeller*, 257 U.S. at 176; *Cullinan v. Walker*, 262 U.S. 134 (1923); *Marr*, 268 U.S. at 536) (emphasis added).

Like *Marr*, *Koshland* therefore gestured toward the income, disposition, and realization models without saying which controlled. This led to confusion in the lower courts. *Compare, e.g.*, *Sprouse v. Comm'r*, 122 F.2d 973, 977 (9th Cir. 1941), *and Dreyfuss v. Manning*, 44 F. Supp. 383 (D.N.J. 1942), *with Strassburger v. Comm'r*, 124 F.2d 315 (2d Cir. 1941).

This Court resolved the lower court split in 1943. In *Helvering v. Sprouse*, 318 U.S. 604, 608 (1943), this Court decisively concluded that the proportionate-interest test controlled. This Court held:

> [*Koshland*] was a case where there were both preferred and common stockholders and where a dividend in common was paid on the preferred. We held, in the circumstances there disclosed, that the dividend was income but we did not hold that any change whatsoever in the character of the shares issued as dividends resulted in the receipt of income. On the contrary the decision was that, to render the dividend taxable as income, there must be a

> change brought about by the issue of shares as a dividend whereby the proportional interest of the stockholder after the distribution was essentially different from his former interest.

Id. at 607–08. A change in the proportional ownership interest, of course, would result in economic income (or loss) to the shareholder-taxpayer.

Thus, the corporate-reorganization and stock-dividend cases affirmed Congress's power to tax transactions generative of economic income, regardless of whether the taxpayer disposed of the initial capital investment or had any control over corporate assets.

CONCLUSION

This case requires the Court to decide whether the Sixteenth Amendment authorizes Congress to tax unrealized gains. *Eisner v. Macomber*, 252 U.S. 189 (1920), is central to this dispute, and Petitioners rely on *Macomber* to argue that Congress can only tax realized gains under the Sixteenth Amendment. Pet. Br. 1–2, 14–15, 17–22.

After this Court's doctrinal refinement in the lease-improvement and corporate-reorganization cases, *Macomber* is today a case about income, not realization. That is, under *Macomber*, Congress may tax under the Sixteenth Amendment an object or

transaction generative of economic income—without regard to realization.

Respectfully submitted.

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